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No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

STOUGHTON TRAILERS, INC.,
a Wisconsin corporation,
Petitioner,

vs.

PACE DESIGN & FAB., INC.,
a California corporation,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Where a corporate subsidiary of two parent corporations is dissolved and its assets and liabilities are transferred to a newly formed subsidiary, which transaction has no financial impact on third parties in pending litigation, does Fed. R. Civ. Proc., Rule 60, Relief from Judgment or Order, or Rule 25(c), Transfer of Interest, empower a District Court to fasten a $375,000 judgment liability on one of the two corporate parents?

2. For the mere nondisclosure of a corporation reorganization without financial loss or detriment to adverse parties in litigation, is it a violation of the due process clause under the Fourteenth Amendment of the United States Constitution and such a departure from accepted and usual course of judicial proceedings to warrant this Court's review, for the district court to impose upon a parent corporation a $375,000 penalty judgment under the guise of "relief" from fraud under Fed. R. Civ. Proc., Rule 60(b)?

PARTIES TO THE PROCEEDING

Petitioner Stoughton Trailers, Inc. ("Stoughton Trailers") is a Wisconsin corporation that does not have shares issued to the public. Stoughton Composites, Inc. ("Composites, Inc."), is a dissolved Wisconsin corporation, the shares of which were owned by Stoughton Trailers (80 percent) and by Alcoa (20 percent), a corporation whose shares are publicly traded. Stoughton Composites, LLC ("Composites LLC"), is a Wisconsin Limited Liability Company, which is owned by Trailers, Inc. (80 percent) and by Alcoa (20 percent)

Respondent Pace Design & Fab., Inc. ("Pace Design"), is a California corporation that does not have shares issued to the public.

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The Order on Motion to Confirm Arbitration Award by the United States District Court for the Central District of California (the "District Court") was filed on June 20, 1996, and is unreported (Appendix F herein).

The Memorandum Decision of the United States Court of Appeals for the Ninth Circuit (the "Ninth Circuit Decision") affirming the District Court Amended Judgment was filed on December 18, 1997, and is unreported (Appendix A herein).

JURISDICTION

The judgment of the Ninth Circuit Court of Appeals affirming the District Court Amended Judgment was filed December 18, 1997 (Appendix A herein). The Petition for Rehearing was denied by the Court of Appeals on January 27, 1998 (Appendix B herein). The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISION AND RULES OF CIVIL PROCEDURE INVOLVED

Fourteenth Amendment, United States Constitution:

> "Section 1 . . . . nor shall any State deprive any person of life, liberty, or property without due process of law; . . ."

The pertinent text of the following Rules of Civil Procedure is set forth in Appendix G:

Federal Rules of Civil Procedure, Rule 25(c).
Federal Rules of Civil Procedure, Rule 60(b).

STATEMENT OF THE CASE

1. The Arbitration Award.

This action for breach of contract arose out of a 1993 agreement between Pace Design & Fab., Inc. ("Pace Design"), and Stoughton Composites, Inc. ("Composites, Inc.") that provided for Pace Design to design and build a container assembly line in Broadhead, Wisconsin. Composites, Inc., was a corporate subsidiary organized by two stockholders, Stoughton Trailers, Inc. ("Stoughton Trailers"), and Alcoa, a publicly held, NYSE-listed company. Composites, Inc.'s ownership was held on a 80/20 basis by, respectively, Stoughton Trailers and Alcoa.

The agreement between Pace Design and Composites, Inc., was an arm's length business transaction. Neither parent company, Stoughton Trailers nor Alcoa, had any legal or financial involvement in their subsidiary's obligations in the transaction. A contract dispute resulted in Pace Design filing suit in a California state court against Composites, Inc. for recovery of alleged fees owed. Stoughton Trailers was not a party to the action.

The action was removed by Composites, Inc., to the United States District Court for the Central District of California. The parties to this action thereafter agreed to submit the dispute to binding arbitration and a retired judge was selected to arbitrate the dispute and make an award. The arbitrator issued an award on March 22, 1996. This award consisted of principal and interest totaling $375,000.

2. The Reorganization.

The state of Wisconsin in 1994 enacted legislation permitting the formation of limited liability companies. Pursuant to the agreement of its two shareholders, Stoughton Trailers and Alcoa, their subsidiary, Composites, Inc., was dissolved and reorganized into a limited liability company, Composites, LLC. The transaction resulted in a transfer to Composites, LLC of the assets and liabilities of Composites, Inc. All legal and financial requisites, including bank agreements, were maintained.

On December 1, 1995, Composites, LLC executed an "Assumption of Liabilities," by which it agreed to assume the liabilities of its predecessor in interest, Composites, Inc. Nothing concerning the reorganization was ever claimed to have been unlawful or wrongful under any law. Pace Design, the District Court, and the arbitrator were not, however, informed of the dissolution and reforming of the Composites' subsidiary into a different legal form. This "nondisclosure" served as the basis for the District Court to later add one, Stoughton Trailers, of the two parents of the Composite subsidiaries to the $375,000 judgment.

3. Proceedings Below.

Pace Design moved to confirm the award as a judgment against Composites, Inc. On June 24, 1996, the District Court entered an Order confirming the Award as a judgment (Appendix F herein) and also entered judgment in favor of Pace Design and against Composites, Inc. (Appendix E herein).

Composites, Inc., appealed the portion of that judgment that provided for post-judgment interest. This appeal was heard in the Ninth Circuit under Docket No. 96-56165.[1]

Pace Design began execution on its judgment against Composites, Inc., in Wisconsin and obtained a writ of execution against Composites, Inc., *and* Composites, LLC. Composites, LLC, not then being a party to the judgment, moved to delete itself from the judgment and the District Court for the Eastern District of Wisconsin ordered Composites, LLC deleted from the writ of execution. That decision is published in the official reports at 936 F. Supp. 599 (E.D. Wis. 1996).

Pace Design thereafter filed a motion in the District Court on August 29, 1996, to *amend* the judgment to add the company into which Composites, Inc., had reorganized, Composites, LLC, and also Stoughton Trailers, as *judgment defendants*. This was styled as a Rule 60 Relief from Judgment or Order.[2] Pace Design sought to add Stoughton Trailers, one of two parent corporations, under a Rule 60(b) motion on the basis that the *failure to disclose* the corporate reorganization was a "fraud."

Both Stoughton Trailers and Composites, LLC opposed the motion. The District Court granted the motion, adding not only Composites, LLC,[3] but also

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[1] The appeal was denied and is not pertinent to this Petition. It was heard with the subject of this Petition and the Ninth Circuit's discussion of that appeal comprises section II of the Ninth Circuit's Decision (Appendix A-2, 3).

[2] Because the original judgment was on appeal, Pace Design sought an indication from the district court on the authority of *Crateo, Inc., v. Intermark, Inc.*, 536 F.2d 862 (9th Cir. 1976).

[3] The proper successor in interest pursuant to FRCP, Rule 25(c) or FRAP, Rule 43(b).

against Stoughton Trailers, to the Amended Judgment. The District Court did so for the stated reason that to do otherwise would be an "injustice." (Appendix D herein) Stoughton Trailers, and Composites, LLC appealed. (No. 97-55032).

On December 18, 1997, the Court of Appeals filed its Memorandum Decision affirming the District Court's Amended Judgment in all respects. (Appendix A herein). Stoughton Trailers filed a Petition for Rehearing, which was denied on January 27, 1998 (Appendix B herein). Stoughton Trailers moved to stay issuance of the Mandate pending the filing of this Petition for Writ of Certiorari. This was granted on February 12, 1998, pursuant to FRAP, Rule 41(b) (Appendix C herein).

REASONS FOR GRANTING THE WRIT

1. Introduction.

It is recognized that it is a rare occasion in which this Court becomes involved with a particular Circuit's interpretation and application of the Federal Rules of Civil Procedure. And it is acknowledged that the district courts are accorded discretion in the administration of justice in every action.

But, it is also true that judges must follow the law. And where in the instance a single judge or a circuit panel has failed to follow the law, then this Court is empowered through the writ of certiorari to require the lower courts to do so. This is such a case.

The reorganization of Composites, Inc., *into* Composites, LLC, had no financial or legal effect upon the outcome of the District Court action. This fact was uncontested throughout the pendency of the District

Court case and brought to the attention of the lower courts at every step of procedure. But for Pace Design's being required to substitute or add the successor entity, Composites, LLC, a procedural step costing in the *hundreds* of dollars, there was never a financial impact upon Pace Design, and Pace has never contended there was. There was never any finding in the lower courts' proceedings that Stoughton Trailers *was* an *alter ego* of Composites, inc.

As we establish below, neither the District Court nor the Ninth Circuit articulated factual or legal reasons for the decision to add Stoughton Trailers to the judgment. Yet, the decision to do so had the immediate and proximate consequence of penalizing Stoughton Trailers $375,000 for the failure to "disclose" what in the consequence was immaterial.

2. The Ninth Circuit's Decision Is Devoid Of Any Law Supporting A Finding Of "Fraud" Including Reliance, Causation, Or Damages To Justify A $375,000 Penalty For Not Disclosing The Reorganization.

The Ninth Circuit's Decision concedes that Stoughton Trailers was not a party to the business dispute between Stoughton Composites, Inc., and Pace Design. (Decision, App. A3)[4] The failure to disclose the reorganization between Composites, Inc. and Composites, LLC was labeled a "fraud." Nothing in the Ninth Circuit's Decision, however, states that any statute, tort (under any law), or Rule of Procedure was infringed or violated by

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[4] All references are to the Court's Memorandum Decision except as noted.

the undisclosed reorganization. In any legally cognizable sense of the word, it did *not*.

The Court concluded that "In any event, the annual reports of SC, Inc. and Trailers show that the President, Secretary, and Board of Directors of the two entities were identical, and [that] it was Trailers which agreed to SC, Inc's stipulation with Pace to arbitrate." (Decision, App. A6)[5]

The law of California, which provided the substantive rule of law on whether a parent corporation is liable for the debts of its wholly owned subsidiary is not so. *Western Camps, Inc., v. Riverway Ranch*, 70 Cal.App.3d 714, 138 Cal.Rptr. 918 (1977). Furthermore, "identicality" of officers and directors has *never* been held in California to be a sufficient basis to hold a parent corporation automatically liable for the debts of its subsidiary. Again, the Courts below failed to comply with their duty to articulate factual reasons for their decision. This was done without a pretense of Due Process, and we request this Court issue a Writ of Certiorari commanding the Ninth Circuit to reverse it decision.

This Court will review application of the Federal Rules of Civil Procedure and statutes and the factors a district court will consider in granting "relief" *from* a judgment under Rule 60(b), and they must be extraordinary. *Liljeberg v. Health Services Acquisition Corp.* (1988 US) 108 S.Ct. 2194, 100 L.Ed.2d 855. (Failure of district judge to disqualify himself pursuant to 28 U.S.C. § 455(a) and motion under Rule 60(b) to vacate reviewed on certiorari.) Where a district court has failed to follow the law, there is present such an injustice that

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[5] They were not the same and, furthermore, no one, including Pace Design, alleged that Stoughton Trailers was a party to the arbitration agreement.

warrants this Court's review. Here, there was no articulation in compliance with the law and review is appropriate and essential to the fair application of the law.

Mr. James Hammis' use of a Stoughton Trailers letterhead to "forward" the agreement to arbitrate between Pace Design and Composites, Inc., had no legal effect or consequence and in the event meant nothing. The contract and dispute was between Pace Design and Composites, Inc., regardless of the form it was held in, and the parent, Stoughton Trailers, was not even a party to the civil action.

Specifically, in December, 1995, when the agreement to arbitrate the Pace Design and Composites, Inc., dispute was reached, if the ongoing dissolution of Composites, Inc., and formation of Composites, LLC had been disclosed, the *indisputable result* would have been the addition of Composites, LLC to the arbitration as a defendant.

Never in the District Court or in the Ninth Circuit did Pace Design suggest or allege that it would have done anything different.[6] Had Pace Design then sought to amend its complaint to include the parent, Stoughton Trailers, the issue of the liability of the parent for its subsidiary's liability would certainly have been tested and the attempt would have failed under any statutory or decisional law. By the lower courts' decisions, Stoughton Trailers was denied that opportunity.

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[6] The Ninth Circuit's Decision states that it was "unmoved" by Stoughton's argument that Rule 25(c) was the proper course and that Stoughton should have requested an "evidentiary" hearing. The facts, however, *were* undisputed and the suggestion of such a purposeless exercise does not make the final result square with the law.

Pace Design never alleged, because it could not, that it contracted with Stoughton Trailers. This issue — the absence of any factual relationship between the parent and the subsidiary's obligations to Pace Design — were raised in the District Court as well as in the Ninth Circuit.

And, under established precedent, the hearing on the motion to add Stoughton Trailers to the judgment could solely have been one of *successor liability*:

> "the transferee's right to a hearing under the due process clause is limited to a determination of whether he is a successor in interest and thus liable on the judgment, and not whether he committed the acts with which the transferor was charged)." *3M v. Eco Chem, Inc.*, 757 F.2d 1256 (Fed. Cir. 1985), at 1264.

It was obvious — and undisputed — that Composites, LLC would have been the proper party to be substituted on motion for Composites, Inc,. It was equally clear that Stoughton Trailers was not.

The Court of Appeals in *Luxliner P.L. Export v. RDI/ Luxliner*, 13 F.3d 69 (3d Cir. 1993), expressly held that Rule 25 — which Pace Design avoided labeling its motion for obvious reasons — may *not* be used as a substitute for resolving or determining questions of fact that are summary judgment material:

> "Rule 25(c) "does not require that anything be done after an interest has been transferred." See 7C Wright, Miller, & Kane, Federal Civil Procedure (hereinafter "Wright & Miller") §1958 at 555 (2d ed. 1986). When a

defendant corporation has merged with another corporation, for example, the case may be continued against the original defendant and the judgment will be binding on the successor even if the successor is not named in the lawsuit. . . . Although substitution is usually effected during the course of litigation, substitution has been upheld even after litigation has ended as long as the transfer of interest occurred during the pendency of the case. See, e.g., *Bamerilease Capital Corp. v. Nearbury*, 958 F.2d 150, 153-54 (6th Cir. 1992) (affirming substitution in the context of proceeding to enforce a settlement agreement); *Arnold Graphics Industries, Inc. v. Independent Agent Center, Inc.*, 775 F.2d 38, 40 (2d Cir. 1985) (affirming district court's substitution of successor corporation for original defendant after entry of judgment).

Because joinder or substitution under Rule 25(c) does not ordinarily alter the substantive rights of parties but is merely a procedural device designed to facilitate the conduct of a case, a Rule 25(c) decision is generally within the district court's discretion. . . . To determine whether an entity is a transferee of interest so as to trigger this discretion, however, a district court's mission is one of applying law to facts. We review the

> district court's factual findings for clear error; its application of the law, and the manner in which it finds facts under the law, are subject to plenary review. *Levendos v. Stern Entertainment, Inc.*, 909 F.2d 747, 749 (3d Cir. 1990)." 13 F.3d at 71, 72.

In the lower courts, the undisputed facts prevented under any theory of law Stoughton Trailers from being considered a successor or alter ego — yet that was the effect of the rulings.

State substantive law, of course, determines whether there was any legal basis for Stoughton Trailers to be considered by the District Court as a successor of Composites, Inc. *United States v. Polizzi*, 500 F.2d 856, 907 (9th Cir. 1974). Since Stoughton Trailers was conclusively not a successor, the only conceivable theory of its addition as a defendant in this case would have been as an "alter ego." At best, the lower courts' rulings treated the motion as a disguised motion for summary judgment for which no court could rationally find the facts were undisputed.

Certainly, on the undisputed facts, there was no "injustice " in the relationship between Pace Design and Stoughton Trailers. Indeed, there was no relationship: The shareholder — one of two — had nothing to do with the design contract. And, Pace Design was not "innocent" of knowledge of Composites, Inc.'s financial position at any time. This was an uncontradicted fact that Pace Design never even bothered to contest in the district court.

The only evidence before the district court was that nothing was conditioned upon Stoughton Trailers guaranteeing obligations of its partially owned subsidiary.

Insofar as Composites, Inc.'s ability to respond to the judgment is concerned, Pace Design knew all the time that it was dealing with an ill-liquid party. Knowledge of the capacity and financial condition of the other party to a contract is a key factor in any contract dispute where plaintiff would fasten liability on a shareholder such as Stoughton Trailers. *Western Camps, Inc., v. Riverway Ranch*, 70 Cal.App.3d 714, 138 Cal.Rptr. 918 (1977).

3. The Decision Adding Stoughton Trailers To The Judgment Debt Of Its Partially Owned Subsidiary Was Such A Departure From Accepted And Usual Course Of Judicial Proceedings As To Warrant This Court's Issuance Of Its Writ Of Certiorari.

The Ninth Circuit's Decision was without precedent and said *nothing* concerning whether the traditional elements of fraud were present so as to justify imposition against the parent the judgment against the subsidiary. Included in the action, procedurally or substantively, for fraud are the requisites that a party *relied* to its detriment and that there are *consequent damages* the result of the fraud.

The Ninth Circuit's Decision studiously omits the burden of proof on Pace that was likewise ignored by the District Court, namely, clear and convincing evidence to establish fraud. *Assman v. Fleming*, 159 F.2d 332 (8th Cir. 1947) at 336.

Pace Design never articulated a legal theory to join one of two corporations that owned the subsidiary — in whatever form it was constituted. For the mere non-disclosure — howsoever it may be characterized — of

the reorganization, Stoughton Trailers has been penalized $375,000. That is unjust and was a violation of Stoughton Trailers' due process rights.

The wrong complained of by Pace Design throughout the District Court and appellate proceedings was that it had been the victim of a "fraud." That so-called fraud was a corporate reorganization. That reorganization was not disclosed. Had it been disclosed, the end result would have been a judgment in the District Court against Composites, Inc., and Composites, LLC., which would have been added without objection by a *properly* filed Rule 25 motion.

The Ninth Circuit's Decision omits both the legal elements of reliance and proximately caused damages as well as any discussion of a factual basis that would establish them. It was unprecedented *and* unwarranted and without any rational basis in law.

We therefore request this Court issue its writ to compel the lower courts require a hearing on the extent and nature of any damages *actually sustained* as a result of the nondisclosure. Imposition of a $375,000 penalty judgment against Stoughton Trailers was an indisputable taking away of its property without the due process required by the Fourteenth Amendment.

CONCLUSION

The District Court's adding Stoughton Trailers to the amended judgment of its partially owned subsidiary and the Court of Appeals' affirmation of that amended judgment violated the rules of civil procedure and were such departure from *accepted norms* of judicial proceedings as to warrant issuance of the Writ of Certiorari by this Court. We request the Court issue the Writ.

DATED: March 16, 1998.

Respectfully submitted,

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